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Transcript Exhibit(s)

Docket #	(s): W	3-020	187A	-05-0°	88
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Exhibit #: A | A 2 S | S 2

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Johnson Utilities Company

Certificate of the Convenience and Necessity Applications

in Docket Nos.

WS-02987A-04-0288

WS-02987A-04-0889

WS-02987A-05-0088

**Direct Testimony of** 

**Brian Tompsett** 

Pre-filed August 21, 2006, 9:30 AM

#### **EXHIBITS**

- A-1 Letter of Credit, dated January 23, 2006
- A-2 Letter to Brian Bozzo, dated January 26, 2006
- 1. Please state your name and business address.
- A. My name is Brian Tompsett, and my business address is 5230 East Shea Blvd, Scottsdale, Arizona 85254
- 2. By whom are you employed and in what capacity?
- A. I am employed by Johnson Utilities Company as the Executive Vice President of the Company.
- 3. How long have you been so employed?
- A. I have been employed by the Company for approximately 4 years, but have been involved in the engineering aspects of this particular system for approximately 10 years.
- 4. Please give a brief resume' of your education and experience as it relates to the utility business.
- A. I have a Bachelor of Science degree in Civil Engineering and have been a licensed Professional Engineer for approximately 18 years. I have been involved in the design and operation of water and wastewater facilities for approximately 22 years.



5. Will you please describe for the record the location of the Johnson Utilities Company's water and wastewater systems?

- A. Johnson Utilities system is located in Pinal County, Arizona. The southern most portion of the system is located north of Hunt Highway approximately 5 miles northwest of the Town of Florence. The system extends north to the intersection of Gantzel Road and Ocotillo Road, which approximately 2 miles east of the Town of Queen Creek's incorporated limits.
- 6. Are you familiar with the Commission's Decisions that have been issued in the subject dockets, namely, Decision Nos. 68235, 68236, and 68237, all as issued on October 25, 2005?
  - A. Yes, I am.
- 7. Are you aware that those Decisions require the Company to file a \$500,000 Performance Bond as a condition of those Certificate expansions?
  - A. Yes, I am.
- 8. Has the Company filed that Performance Bond as required?
  - A. No, it is not.
- 9. Will you please explain the Company's efforts in obtaining a Performance Bond?
- A. Yes, on November 7, 2005 our Counsel had a telephone conference with David Ronald and Brian Bozzo of the Staff regarding the form of the bond. Staff indicated that they would provide the form of a bond recently filed by another company that was acceptable to the Commission. However, we did not receive that bond and Staff was again contacted on December 5, 2005. Still not having received the form, counsel wrote a letter to Mr. Bozzo on December 14, and the form a bond was received by the Company on December 16, 2005.

- A. We had numerous discussions with various banks and bonding companies attempting to obtain a traditional Performance Bond containing the language in the Staff provided form. Unfortunately, we could not obtain such a bond.
- 11. Was it the actual bond that could not be obtained, or was it the cost of that bond?
- A. It was both. We were advised that the terms of the bond were not in the form contemplated by the bond underwriters, and that in the event such a bond was issued the annual premium would be approximately \$ 10,000.00.
- 12. How would that adversely impact on the Company and its customers?
- A. That is a recurring cost that would be in place during the term of the bond, which given the nature of the litigation, could have been in effect several years.
- 13. But given the size of the Company, is that expense really significant?
- A. If there was no other option that may be true. However, the Company had an alternative that was virtually cost free and that we believed was a prudent alternative. That alternative provided the protection the Commission sought, and avoided any cost for the Company's ratepayers.
- 14. Given that, what did the Company do?
- A. We obtained a Letter of Credit from National Bank of Arizona containing the language of the Staff's proposed form, and docketed that with the Commission on January 23, 2006. A copy of that bond is attached to this testimony as Exhibit A-1.
- 15. Were their subsequent communications with Staff regarding the issue?
- A. Yes. On January 25, 2006 I received a verbal request from Brian Bozzo requesting an explanation as to why the Company filed a Letter of Credit, not a bond. On

January 26, the Company responded regarding the efficacy of the Letter of Credit. A copy of that letter is attached as Exhibit A-2. We received no response from that letter, and again on March 3, 2006 Counsel requested clarification, to which the Staff responded the Letter of Credit was "unacceptable". Based upon those discussions with Staff, on March 14, 2006 the Company filed Applications to Amend Decision Numbers 68235, 68236, and 68237. In response to that Application the Staff filed a Reply on April 21, 2006 indicating that the Letter of Credit was acceptable.

- 16. Mr. Tompsett, what do you believe to be the motivation and intent of the Commission in requiring the Performance Bond?
- A. Due to the fact that the Company's principal and a related entity were Defendants in outstanding litigation that could have substantial financial consequences, we believe the Commission required the Performance Bond to guarantee that in the event the litigation was resolved against the Defendants, that financial impact would not adversely impact the Company's utility operations. I would also add that Johnson Utilities Company was not a named defendant in the outstanding litigation.
- 17. Will the Performance Bond provide that assurance?
  - A. Yes it would.
- 18. Do you believe the Letter of Credit as provided will provide that assurance to the Commission and protection of customers?
- A. Yes, as Mr. Larry Davis, the Chief Credit Officer of National Bank of Arizona will testify, we believe the protection is actually much greater with the Letter of Credit than with the Performance Bond.

- A. Again as Mr. Davis will explain, not all companies, especially small startup companies, have the ability to obtain a Letter of Credit. Banks typically require substantial assets, often cash, as collateral for Letters of Credit. Many individuals and companies simply cannot meet the bank's requirements.
- 20. You attempted to comply by posting the Letter of Credit shortly after the Decisions were issued. Why did you do that?
- A. A condition of the Decisions was that the Company would not provide retail service to customers within the expansion areas prior to posting the bond. In two of the expansion areas the timing was not critical because the development was in a normal construction cycle and customers would not be requesting retail service for a number of months. However, in Section 17, Township 2 South, Range 8 East, the parcel in Decision No. 68236, the Company was assuming the wastewater operations of AUSS. The subdivisions had been constructed and had already received subdivision approvals from the Arizona Department of Real Estate. There was an existing customer base at the date of the Decision. Even prior to the Decision, and at all time subsequent to the Decision, the Company has provided service only under a Wholesale Agreement with the developers, and is not providing direct retail service, or customer billing, to the individual homeowners within that parcel.
- 21. To date has the Company provided any retail service to any of the areas as forbidden by any of the Decisions?
  - A. No, we have not.

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22. Mr. Tompsett, is it your opinion that the Company's posting of the Letter of Credit meets the compliance requirements of the subject Decisions?

A. I certainly recognize that the precise language of the Decisions state "Performance Bond". However, I believe the intent of the requirement and the level of assurance that the Commission was seeking by that requirement is more than met by the Letter of Credit docketed on January 23, 2006.

- 23. What would be your request of the Commission regarding these matters?
- A. I would request that the Commission issue a clarifying decision in those dockets essentially adopting the language provided by the Staff in its Reply dated April 21, 2006 which found the Letter of Credit an acceptable alternative to the required Performance Bond.

24. Does this conclude your testimony?

A. Yes, it does.

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# JOHNSON UTILITIES, L.L.C

5230 East Shea Boulevard \* Scottsdale, Arizona 85254 PH: (480) 998-3300; FAX: (480) 483-7908

January 24, 2006

Brian Bozzo Arizona Corporation Commission 1200 W. Washington Street Phoenix, Arizona 85007

RE:

Johnson Utilities, L.L.C.: Compliance with Decision No. 68235; 68236; 68237

RE: \$500,000 Performance Bond

WS-02987A-05-0088; WS-02987A-04-0889; WS-02987A-04-0288

Dear Mr. Bozzo:

Pursuant to the above mentioned decision, Johnson Utilities hereby submits this compliance filing in accordance with the Commission's order to procure a \$500,000 performance bond prior to retail service being provided to any customers in the CC&N extension area. Enclosed please find the \$500,000 Performance Bond from National Bank of Arizona in the form of an Irrevocable Standby Letter of Credit attached hereto as Attachment No. 1. Johnson Utilities will file on or before April 15, 2006 a letter of bond confirmation as required by this Decision.

If you need any additional information in regards to this compliance item, please do not hesitate to contact me. Thank you for your time and consideration in this matter.

Sincerely

Daniel Hodges
Johnson Utilities, LLC

Cc: Ernest Johnson, Director

Brian Tompsett, Johnson Utilities

Richard Sallquist, Sallquist, Drummond & O'Connor

Docket Control

# ATTACHMENT 1



LC #:

10566

Date:

January 6, 2006

Amount: 500,000.00

ARIZONA CORPORATE COMMISSION 1200 West Washington Phoenix, AZ. 85007

#### IRREVOCABLE STANDBY LETTER OF CREDIT

#### GENTLEMEN:

AT THE REQUEST OF: JOHNSON UTILITIES, L.L.C., an Arizona limited liability company, 5230 East Shea Blvd., Suite 200, Scottsdale, Az. 85254

FOR THE ACCOUNT OF: JOHNSON UTILITIES, L.L.C., an Arizona limited liability company, 5230 East Shea Blvd., Suite 200, Scottsdale, Az. 85254

WE HEREBY OPEN IN YOUR FAVOR OUR IRREVOCABLE STANDBY LETTER OF CREDIT FOR SUM OR SUMS NOT EXCEEDING FIVE HUNDRED THOUSAND AND NO/100 U.S. DOLLARS

AVAILABLE BY YOUR DRAFT(S) AT SIGHT ON US

NATIONAL BANK OF ARIZONA Documentation Dept. AZ 7013 6001 N. 24<sup>th</sup> Street, PHOENIX, AZ 85016

WHEN DRAWN IN ACCORDANCE WITH THE TERMS AND ACCOMPANIED BY THE DOCUMENTS LISTED BELOW.

KNOW ALL MEN BY THESE PRESENTS, THAT WE, JOHNSON UTILITIES, L.L.C., AS PRINCIPAL AND NATIONAL BANK OF ARIZONA, AS SURETY ARE HELD AND FIRMLY BOUND UNTO THE ARIZONA CORPORATE COMMISSION IN THE AMOUNT OF FIVE HUNDRED THOUSAND AND 00/100 (\$500,000.00) LAWFUL MONEY OF THE UNITED STATES OF AMERICA FOR THE PAYMENT OF WHICH THE PRINCIPAL AND SURETY ARE HEREBY JOINTLY AND SEVERALLY BOUND.

NOW THEREFORE, IF THE SAID PRINCIPAL, OR ANY ASSIGNS OF HIS FAILS TO PROVIDE COMPETITIVE WATER AND WASTEWATER SERVICES SO FURNISHED, THE SAID SURETY WILL PAY THE SAME TO THE USERS OF THE PRINCIPAL WITH THE CONSENT OF THE ARIZONA CORPORATE COMMISSION AS TRUSTEE, AN AMOUNT NOT EXCEEDING THE SUM HEREINABOVE SPECIFIED, THEN THIS OBLIGATION SHALL BE NULL AND VOID; OTHERWISE IT SHALL REMAIN IN FULL FORCE AND EFFECT.

PROVIDED FURTHER, THAT REGARDLESS OF THE NUMBER OF YEARS THIS LETTER OF CREDIT SHALL CONTINUE IN FORCE AND THE NUMBER OF PREMIUMS WHICH SHALL BE PAYABLE OR PAID, THE SURETY SHALL NOT BE LIABLE THEREUNDER FOR A LARGER AMOUNT, IN THE AGGREGATE, THAN THE AMOUNT OF THE BOND.

THIS LETTER OF CREDIT SHALL BE AUTOMATICALLY EXTENDED FOR AN ADDITIONAL PERIOD OF ONE YEAR FROM THE PRESENT OR EACH FUTURE EXPIRATION DATE UNLESS WE HAVE NOTIFIED YOU IN WRITING, NOT LESS THAN THIRTY (30) DAYS BEFORE SUCH EXPIRATION DATE, THAT WE

Unless otherwise expressly stated, this Letter of Credit is subject to the Uniform Customs and Practice for Documentary Credits, established by The International Chamber of Commerce Publication, applicable on the date of this Letter of Credit.



ELECT NOT TO RENEW THIS LETTER OF CREDIT. OUR NOTICE OF SUCH ELECTION SHALL BE SENT CERTIFIED MAIL TO YOUR ABOVE ADDRESS (OR SUCH OTHER ADDRESS AS YOU MAY ADVISE US OF IN WRITING).

PARTIAL DRAWINGS ARE ALLOWED.

THE ORIGINAL OF THIS LETTER OF CREDIT MUST BE PRESENTED WITH ANY AND ALL DRAWINGS EFFECTED HEREUNDER. WE HEREBY AGREE WITH YOU THAT DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS CREDIT, THAT SUCH DRAFTS, WILL BE DULY HONORED IF PRESENTED AT NATIONAL BANK OF ARIZONA, DOCUMENTATION DEPT. AZ 7013, 6001 NORTH 24<sup>th</sup> STREET, PHOENIX, AZ 85016 ON OR BEFORE **JANUARY 6, 2007**.

DRAFTS DRAWN UNDER THIS CREDIT MUST BE ENDORSED AND CONTAIN THE CLAUSE "DRAWN UNDER NATIONAL BANK OF ARIZONA LETTER OF CREDIT NO. 10566 DATED JANUARY 6, 2006."

NATIONAL BANK OF ARIZONA

AUTHORIZED SIGNATURE

Unless otherwise expressly stated, this Letter of Credit is subject to the Uniform Customs and Practice for Documentary Credits, established by The International Chamber of Commerce Publication, applicable on the date of this Letter of Credit.

# SALLQUIST, DRUMMOND & O'CONNOR, P.C.

ATTORNEYS AT LAW
TEMPE OFFICE
4500 S. LAKESHORE DRIVE
SUITE 339
TEMPE, ARIZONA 85282

RICHARD L. SALLQUIST

PHONE (480) 839-5202 FACSIMILE (480) 345-0412 E-MAIL dick@sd-law.com

January 26, 2006

#### EMAIL AND US MAIL

Mr. Brian Bozzo, Compliance Officer Arizona Corporation Commission Utilities Division 1200 West Washington Street Phoenix, Arizona 85007

Re: Johnson Utilities Company; Docket Nos. WS-02987A-04-0288, WS-02987A-04-00889, & WS-02987A-05-0088; Decision Nos. 68237, 68236, & 68235, respecively; Compliance Bond

Dear Mr. Bozzo:

We are writing in response to your question to Mr. Tompsett regarding the efficacy of providing a Letter of Credit as opposed to a performance bond as the compliance requirement in subject Decisions. We submit that the Letter of Credit not only meets the requirement of those Decisions, but is a superior financial assurance than the form of performance bond you provided as a guide to the compliance requirement.

Please note the features of the Letter of Credit filed in the subject Dockets on January 23, 2006 that are equal to, or superior to, the form of bond you provided.

- 1. The purpose and function of the two instruments is identical. The funds will be available to the Commission in the event of adverse consequences to the Company resulting from the subject litigation.
- 2. The language of the Letter of Credit is virtually identical to the bond form you provided.
  - 3. A Letter of Credit is a more secure financial instrument than a bond. The issuer of the Letter of Credit actually holds the Principals cash in the amount of the Letter of Credit, not just lien rights on assets as with a bond. In the commercial world, a secured party would vastly prefer a Letter of Credit to a bond.

- 4. The Letter of Credit is available to the Commission upon presentation of "draft(s) at site" as set forth in the Letter of Credit. Contrast that with the complex and time-consuming "claim" required under a bond or insurance instrument. It should be noted that those procedures are not even set forth in the bond terms.
- 5. The Letter of Credit provided to the Commission is issued by a well-established local bank, not a foreign insurance company. Therefore, executing on the Letter of Credit is much easier for the Commission.

As you are aware, in the past the Commission has, when requiring financial assurances associated with new certificated areas, included language in decisions requiring a "performance bond or letter of credit". Many small companies that are either underfinanced or whose owners have no established banking relationship are unable to obtain a letter of credit. In this instance a Letter of Credit is available. We believe the purpose and intent of the Commission is to be certain that funds are available to assure the ongoing operation of the utility and the provision of the service which the Commission has authorized. Either financial assurance would provide that, however as stated above, we believe the Letter of Credit provides even greater assurances to the Commission and is consistent with their intent.

In the event you have further questions please do not hesitate to call.

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Richard L. Sallquist

Cc: Docket Control (15 copies in each Docket)

David Ronald Brian Tompsett

Johnson Utilities Company 1 Certificate of the Convenience and Necessity Applications 2 in Docket Nos. WS-02987A-04-0288 3 WS-02987A-04-0889 WS-02987A-05-0088 4 **Direct Testimony of** 5 **Larry Davis** Filed August 24, 2006, 6 Superseding Prefiled Document of August 21, 2006 7 **EXHIBITS** A-1 Letter of Credit, dated January 23, 2006 8 A-2 Letter to Brian Bozzo, dated January 26, 2006 9 Please state your name and business address. 1. 10 My name is Larry Davis, and my business address is 6001 N. 24th Street, A. 11 Phoenix, Arizona 85016. 12 By whom are you employed and in what capacity? 13 I am employed by National Bank of Arizona as the Chief Credit Officer of A. 14 the Company. 15 How long have you been so employed? 16 I have been with the Bank for approximately 10 years. A. 17 Please give a brief resume' of your education and experience as it relates to the utility 18 business. 19 I have been in the banking business in Arizona for over 35 years. A. 20 includes 18 years with Arizona Bank, 5 years with Caliber Bank, and 10 with National 21 Bank. 22 Are you familiar with George Johnson and the Johnson Utilities Company? 23 Yes, I am. A. **EXHIBIT** 

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make payment) if the beneficiary submits certain defined documents to the issuing bank. In this case, NBA would be the issuing bank and the Commission would be the beneficiary. While the letter of credit is requested by an "account party", in this case Johnson Utility Company (the "Company"), the account party is not a party to the letter of credit contract. A letter of credit is designed to be easy to interpret, exercise and enforce. It does not require, or even allow, that the issuing bank investigate whether the draw request is appropriate or not—if the draw request is made in accordance with the requirements set forth in the letter of credit (i.e., if the proper documents are submitted), the issuing bank pays with no more questions asked. If the draw request is not exactly in conformance, then the issuing bank cannot pay. However, the advantage of a letter of credit is that it is short and concise, usually one or two pages, and it should clearly spell out exactly what the beneficiary needs to do to draw on the letter of credit. Letters of credit are widely accepted by county and municipal governments throughout the United States as an alternative to performance bonds for construction and development projects.

- 12. So that I get the right terminology, we please identify the names of the parties to the Letter of Credit for the Bank, the Company, and the Commission?
- A. Yes, the Bank is known as the issuer or issuing bank, and the Company is known as the account party. The Commission would be the beneficiary under this instrument. The language required by the Commission also calls the Bank a "Surety", the Company a "Principal" and the Commission a "Trustee" for the "Users of the Principal". However, we believe that this language does not affect the operation of the Letter of Credit, that the Bank would pay the Letter of Credit proceeds directly to the Commission upon receipt of a conforming draw request.

It is up to the issuing bank to determine whether it needs collateral security

The

and/or guarantees, or whether it is comfortable issuing a letter of credit on an unsecured or 3 unguaranteed basis. The beneficiary is not affected by whether or not the issuing bank has 4 5 collateral or guarantees, because the letter of credit is an independent obligation of the bank, and the bank will have to honor any conforming draw requests, whether or not the 6 7 bank has recourse to the account party, a guarantor, or any of their assets.

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A.

In the event of the Company's failure to perform its obligations, how would the 14. Commission make a claim or execute on the Letter of Credit?

Commission is "secured" by the fact that the letter of credit is a direct obligation of the

A. Once the Commission, as beneficiary, determines that the conditions exist that justify a draw on the Letter of Credit, the Commission would submit a draw request, consisting of a sight draft accompanied by the original Letter of Credit, to the Bank, Upon presentation of that documentation to our Documentation Department at 6001 N. 24th St Phoenix, AZ 85016, the Bank would provide the proceeds of the Letter of Credit.

- 15. So the documentation required would merely be the Commission's determination that the Company had not performed?
- A. No. The required documentation consists of a sight draft and the original of the Letter of Credit. The Letter of Credit could have been written so that the Commission would also have to provide a signed certification that the Company had not performed, but that was not required in the current version of the Letter of Credit. However, it stands to

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the Company would affect the Bank's obligation to honor draw requests by the

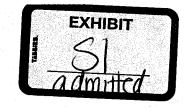
Commission. However, I am no bankruptcy expert, and it may be possible that the

bankruptcy court could issue an order staying any action on the Letter of Credit, but I assume that the Commission could move for and receive relief from any such stay.

- 21. What would be the impact if the Bank were to have financial difficulties or declare bankruptcy?
- A. I believe that the Commission would be an unsecured creditor of the Bank. However, it is very unlikely that the Bank will fail. National Bank of Arizona is a \$42 billion dollar company that has been operating in Arizona since 1982. Our parent is Zions Bancorporation, a publicly traded company.
- 22. Mr. Davis, are you familiar with Performance Bonds?
  - A. I am not an expert, but I am generally familiar with those documents.
- 23. Are the terms contained in your Letter of Credit typical to a Performance Bond?
- A. I do not believe so. My understanding is that Performance Bonds are typically tied to a narrowly defined event or specific contract that has defined terms of default. The Bond is basically an insurance contract, and I believe that they can be several pages in length. They may not be as clear and concise as a letter of credit, and may contain provisions or fine print that can make their exercise subject to other preconditions.
- 24. Other than that, how are Performance Bonds different than Letters of Credit?
- A. A Performance Bond is basically an insurance policy. With a bond, the Commission would be looking to the assets of the insurance company, instead of to the assets of a bank. A bond may allow a "process" whereby the insurance company investigates the claim made under that bond. A Letter of Credit, on the other hand, is designed to be more "ministerial" in nature, requiring the Bank to honor a draw request

upon the Commission's satisfaction of a few clearly defined steps, i.e., submiss	ion of a sight
draft and the original Letter of Credit, as spelled out in the Letter of Credit.	

- 25. Are the Bond premiums more than Letter of Credit fees?
- A. Yes, I understand those annual premiums can run from 2 to 10 % of the Bond, depending on the event secured and the financial strength of the secured party.
- 26. How does one make the claim on a Performance Bond?
- A. I believe that the Commission would make a claim, not unlike the claim under any insurance policy, and then the insurance company and its underwriters could scrutinize the claim to see if it was within the terms of the bond. My understanding is that this typically takes a number of weeks, if not months.
- 27. What proof would the Commission need to present?
- A. That depends on the exact language in the bond contract. The claim procedure could vary from insurance company to insurance company.
- 28. In your opinion which document or instrument better secures the Commission and the Company's customers in the event a claim would need to be made in this matter?
- A. I believe it is well accepted in the financial industry that a Letter of Credit is substantially more secure than a Performance Bond, in the sense that it is more sure in its operation and it provides funds directly to the Commission for the Commission to use as it sees fit to provide the necessary services to the customers.
- 29. Does that conclude your testimony?
  - A. Yes, it does.



# JOHNSON UTILITIES COMPANY

**DOCKET NO. WS-02987A-04-0889** 

OF
WILLIAM F. HAUG

ON BEHALF OF
COMMISSION STAFF

**AUGUST 21, 2006** 

A. Yes, I have considered the general issue of how the Commission might best ensure utility performance. I have also analyzed JUC's proposed form of letter of credit to determine how effective it might be.

# Q. HAVE YOU REDUCED THE OUTCOME OF YOUR ANALYSIS TO WRITING?

A. Yes, I have attached to this testimony Exhibit 2, which is entitled "Declaration of William F. Haug" (the "Declaration"). My Declaration describes many of the concerns I have regarding the efficacy of the Commission's attempt to ensure utility performance by means of either performance bonds or letters of credit. I describe some of the elements which should be considered by the Commission in adopting one of these devices as a mechanism to either protect utility ratepayers from losses or to ensure that utilities provide "adequate" service.

## Q. WOULD YOU PLEASE SUMMARIZE YOUR CONCLUSIONS?

A. If adopted with appropriate standards and procedures in place, either a performance bond or a letter of credit can be utilized for the intended purpose. It is not clear to me that all of the necessary requirements to ensure that the surety device is effective have been incorporated into previous Commission Orders. I am also concerned that, because the Commission may not have the authority to receive funds under a surety device and distribute them to customers, it may be difficult for the Commission to accomplish its objective without legislative enactment.

Additionally, and in particular, I conclude that the proposed form of letter of credit proffered by JUC will not adequately ensure that the utility provides "adequate" service.

## Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

#### WS-02987A-04-0889 EXHIBIT 1

William F. Haug Senior Partner Phone: 602-234-7806 Facsimile: 602-277-5595 Email: wfh@ihc-law.com

Phoenix

Mr. Haug is an-experienced litigator with an extensive background in civil litigation. His trial and litigation experience includes complex construction and fidelity and surety disputes representing all aspects of the construction industry, including both public and private owners, architects and engineers, contractors, subcontractors, material suppliers and sureties.

His experience also includes over 35 years representing his clients in arbitrations and mediations, including serving as an arbitrator and mediator in construction disputes.

#### **EDUCATION**

LLB, University of Arizona, 1956

B.S. in Business Administration, University of Arizona, 1953
 Major in Accounting

B.A. from Phoenix College, 1951

### ADMITTED TO PRACTICE

- Arizona
- Arizona Supreme Court
- United States Supreme Court
- United States Court of Claims
- U.S. Court of Appeals, Ninth Circuit
- U.S. District Court, District of Arizona

#### PROFESSIONAL AFFILIATIONS

- State Bar of Arizona, President (1982-83)
  - Construction Law Section
  - Alternative Dispute Resolution Section
- Maricopa County Bar Association, President (1975)
  - Construction Law Committee
- Arizona Foundation for Legal Services and Education, President (1994)
- American Bar Association
  - Tort and Insurance Trial Practice Section, Past Secretary and Financial Officer
  - o Fidelity and Surety Law Committee Chairman (1983-84)
  - o Forum on the Construction Industry Hard Hat Case Note Editor (1980s)
- American Bar Foundation, Life Member (1991)
  - International Association of Defense Counsel
    - Fidelity and Surety Law Committee
- o Construction Law and Litigation Committee
- Defense Research Institute
- Arizona Association of Defense Counsel

Surety Association of Arizona, Honorary Member

American Arbitration Association (Complex Case Panel)

#### REPRESENTATIVE ENGAGEMENTS

 Served as National Bond Counsel for a Surety Company overseeing surety claims throughout the United States

Successfully defended sureties on bad faith claims

 Obtained defense judgments in all types of fidelity cases both in State and Federal Courts

 Represented contractor in mechanic lien suit involving a multi-million dollar electric generating plant

 Successfully represented subcontractors in lawsuits involving pay when paid and pay if paid clauses

 Served as Chair of Arbitration panel involving a multi-million dollar claim on a condominium project

Arbitration panel member on a multi-million dollar dispute involving a huge freeway and drainage project

Successfully mediated many construction disputes

 Drafted and secured the adoption by the Arizona Legislature of Arizona Public Works bonding statutes, lien release and discharge bond statutes on private projects and bonding provisions in the Arizona Uniform Probate Code

#### REPRESENTATIVE REPORTED DECISIONS

 National Bank of Arizona v. St. Paul Fire and Marine Ins. Co., 193 Ariz. 581, 975 P.2d 711, Ariz. App. (1999). Suit against insured does not state a claim against Officers and Directors and, therefore, is outside the coverage under the Directors and Officers Liability Policy.

Cannon Dist. No. 50 v. W.E.S. Construct. Co., Inc., 177 Ariz. 526, 869 P.2d 500 (1994). School District was bound by the arbitration provision in its

contract.

Dodge v. Fidelity and Deposit Co. of Maryland, 161 Ariz. 344, 778 P.2d, 1240 (1989). A surety in Arizona is subject to bad faith claims as the surety is regulated by the State Insurance Department under the Insurance Code. Tells sureties what to do to in order to avoid bad faith.

Pioneer Roofing Co. v. Mardian Construct. Co., 152 Ariz. 455. 733 P.2d, 652 (1986). This case establishes the time when a claim must be brought on Public Works Projects and addresses the pay when paid clause provisions

of the contract.

• Employers' Administrative Services, Inc. v. Hartford Acc. & Indem. Co., 147 Ariz. 202, 709 P.2d 559 (1985). This case established the surety's right to

assert the alter-ego defense on fidelity bonds.

Murdock-Bryant Const., Inc. v. Pearson, 146 Ariz. 48, 703 P.2d 1197 (1985).
 This case established that the receipt of benefit by the owner is sufficient to support restitution and a quantum merit recovery where the owner is not a party to the contract.

J.R. Norton Co. v. Fireman's Fund Insurance Co., 116 Ariz. 427, 569 P.2d 857 (Ariz. at 1977). Where, some loss is shown by the insured, insured can establish its damages through inventory computations or profit/loss

computations.

• U.S. Fidelity & Guaranty Co. v. Christoffel, 115 Ariz. 507, 566 P.2d, 308 (Ariz. at 1977). The court established that liability on the guardian's bond for a

definite period is limited to the amount of the bond and not cumulative for each year the bond is in effect.

• *Maryland Gas Co. v. Clements,* 15 Ariz. at 216, 487 P.2d, 437 (1971). This case established what constitutes notice of dishonesty so as to terminate liability of the surety for future acts of the employee.

Lincoln Technical Institute of Arizona, Inc. v. Federal Ins. Co., 927 Supp. 376
 (D. Ariz., 1994): An endorsement increasing policy limits applies only to losses after the date of the endorsement.

#### SELECTED PUBLICATIONS & PRESENTATIONS

• Surety's Liability: Bonds, Arizona Construction Law 2d Ed., published by the State Bar of Arizona (1994).

 Authored Arizona's Little Miller Act, Mechanics Lien Discharge Bond statutes and the Bond provision in Arizona's Uniform Probate Statutes.

• Co-author "Bankruptcy 1984 v. Surety's Rights to Contract Proceeds" 20 Forum 725 (1985).

"Dodge vs. Fidelity & Deposit - The Final Chapter" in <u>Tips Fidelity and Surety</u>
 <u>Law Committee Newsletter</u>, Spring/Summer (1992).

• "Decision by Insurer Not to Defend Insured Against Claims Cognizable under Bonds", 12 Forum 410 (1976).

• "Financing your 'Solvent' Principal— Success Failure", Fidelity & Surety Law Committee, San Francisco, CA, January 1996.

#### **AWARDS AND HONORS**

- 2001, Martin J. Andrews Award for Lifetime Achievement in Fidelity and Surety Law, presented by the Fidelity & Surety Law Committee of the and Insurance Trial Practice Section of the American Bar Association.
- 2004, "Silver Star Award" from the Governor of Arizona for his involvement in creating the Arizona Foundation for Legal Services and Education, 2004.
- August 2005 Volunteer Lawyer Program, Attorney of the Month for his 50-year ongoing commitment to Pro Bono service.
- 2006, Honored for his 50 years of exemplary services in the field of Construction and Surety by the Construction Law Section of the State Bar Arizona.
- 1998 ISO Silver Award for Excellence in Surety Bond Promotion presented by the Surety Association of Arizona.

#### **COMMUNITY ACTIVITIES**

- Maricopa County Bar AssociationVolunteer Lawyers Program
- Creighton School Board (1966.-.75)
- Phoenix Retriever Club (1970.-.90)

#### AREAS OF PRACTICE

- Construction Law
- Fidelity & Surety Law
- Litigation
- Arbitration and Mediation

#### WS-02987A-04-0889

#### **EXHIBIT 2**

## Declaration of William F. Haug

I am a lawyer admitted to the State Bar of Arizona and have been practicing law for almost 50 years. For most of my practice I have been involved with bonds of all types including performance, utility, license and court bonds, as well as letters of credit. In my practice I have primarily represented sureties. In the issuance of bonds, it is not uncommon for sureties to use letters of credit as security against loss where the principal on the bond might have some credit issues. Although bonds are common in the construction industry, the parties do sometimes use letters of credit in lieu of bonds. In fact, from the obligee's or beneficiaries' standpoint, they may be better than bonds since there is normally no defense available to the bank who must and will pay when the beneficiary draws upon the bank. Sometimes the letter will require other documents to accompany the draft drawn to obtain the bank's funds such as invoices, bills of lading and declarations of default.

Letters of credit accomplish their purpose by substituting the credit of the bank for that of the customer. There are basically two types: commercial and standby. The two letters serve different functions. Commercial letters of credit which have been used for centuries to facilitate payment in international trade is the primary payment mechanism for the transaction. The standby letter of credit serves a completely different function. A bank will issue a standby letter of credit on behalf of a customer to provide assurance of the customer's ability to perform under the terms of a contract with the beneficiary. The parties involved in the transaction do not expect that the letter of credit will ever be drawn upon. The letter of credit at issue here would be a standby in that it is intended to guaranty that the utility company will provide its users with adequate services.

Bonds which provide the same protection are a suretyship obligation. It is a triparty transaction wherein the surety extends its credit to guaranty that the principal will fulfill its obligations to the obligee. The surety obligation is secondary and only arises if the principal fails to perform its obligations to the obligee. Under this arrangement the surety, in the event of a default by the principal, can raise not only its own defenses to payment but also any defense that its principal might have.

With that overview, we will now look at Johnson Utilities Company's Performance Bond and its proposed letter of credit which tracks the bond form. Although bonds and letters of credit can accomplish the same thing, that is providing security to the obligee or beneficiary, they are entirely two different types of security devices and cannot be combined as is being attempted here. Under a performance bond, both the principal and surety can raise a defense to making any payment at all. Under the letter of credit, the principal and the bank can raise no defense to the payment to the beneficiary. If the principal believes that the payment should not have been made, then after payment has been made, the principal can take what ever action is appropriate against the beneficiary to get the money back.

The terms of the bonds given to the Arizona Corporation Commission, provide that the bond penalty is to be paid to the users with the consent of the Commission as Trustee. "Trustee" is not an appropriate designation as the Commission never holds anything under the terms of the bond which would make it a trustee because the bond amount is payable to the users. The performance bond is really in the form of a payment bond which although it names the Commission as obligee, it runs to the benefit of the users who are the true obligees, not the Commission, who has no right to receive the bond monies from the surety.

The provisions of the bond are incorporated into the letter of credit without recognizing that it is an entirely different form of security device, even to the extent of using bond terms such as surety, principal and bond. Who is the beneficiary? The bank funds appear to be for the benefit of the users and not the Commission. How do the users draw upon the letter when the bank doesn't know who they are and they do not hold the

original letter of credit? The drafting of this letter of credit evidences a lack of understanding of this security device. Since the beneficiaries are unknown, to whom does the bank send its notice of cancellation? The Commission? The users?

To have a proper letter of credit, the Commission should be the beneficiary to whom the funds would be paid, either for the benefit of the users or as a penalty or fine. The Commission Order granting the Certificate of Convenience and Necessity should spell out the terms of the bond or letter of credit, that is, what is its purpose, what constitutes a default under the security document, and what the Commission is to do with the funds it receives. I have attached sample forms of a letter of credit which the Commission could use in the event it determines that a letter of credit is an appropriate substitution.

In discussion with the Commission's counsel, there appears to be some problem with the Commission receiving the benefits of the letter of credit, unless it constitutes some form of a penalty or fine. I understand that all monies received by the Commission must be paid to the State Fund and would not be available to the users if it was intended to be for their benefit. This might mean there would have to be some legislative changes or at least some rules adopted by the Commission which would provide for a procedure to determine who the users are and the amount of their entitlement.

The bond as currently drafted is of little benefit to the users as their claims are generally so small that it is not worth their effort to try to collect from the bonding company, much less that they even know such bond exists. The surety would probably not pay individual claims because they may not know whether the claims exceed the bond amount. Payment of their claims could cause the surety's liability to exceed the amount of the bond, particularly if the bond amount is relatively small. If the bond proceeds are paid to the Commission, the same problems would exist as with the letter of credit.

If the Commission is legislatively authorized and appropriate rules are established, a letter of credit would be preferable over a bond. However, it could be more expensive to the Commission as it will have to adjust the claims of the users, an expense that would be

incurred by the surety when the bond, as now written, makes the users the beneficiaries. Rules promulgated by the Commission could provide that this expense come out of the bond proceeds or letter of credit before the users are paid.

# EXHIBIT 2 ATTACHMENT 2

(To be prepared on Bank Letterhead)

# EXHIBIT 2 ATTACHMENT 1

e and Address of Lin your favor for
ght.
ROF CREDIT and on presentation of on or before the the below.
not subject to any no way contingent
extended without ion date and any we notify you by ear periods. Such ve address.
ntary Credits (1983
gnature)

(To be prepared on Bank Letterhead)



LC #: Date: Amount:

#### IRREVOCABLE STANDBY LETTER OF CREDIT

**GENTLEMEN:** 

AT THE REQUEST OF:

FOR THE ACCOUNT OF:

WE HEREBY OPEN IN YOUR FAVOR OUR IRREVOCABLE STANDBY LETTER OF CREDIT FOR SUM OR SUMS NOT EXCEEDING SEVENTEEN THOUSAND U.S. DOLLARS

AVAILABLE BY YOUR DRAFT(S) AT SIGHT ON US

NATIONAL BANK OF ARIZONA Documentation Dept. AZ 7013 8001 N. 24<sup>th</sup> Street, PHOENIX, AZ 85016

WHEN DRAWN IN ACCORDANCE WITH THE TERMS AND ACCOMPANIED BY THE DOCUMENTS LISTED BELOW.

We hereby open our irrevocable Standby Letter of Credit in your favor, for the account of (the "Applicant") in the aggregate of \$17,000.00 United States Dollars (Seventeen Thousand and no/100) available by payment of your draft(s) at Sight on Ourselves when accompanied by the following documents:

1. A statement purportedly signed by an authorized officer of

is in default of one or more obligations under one or more contracts or agreements between



2. The original of this Letter of Credit and the original of any amendments.

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Unless otherwise expressly suped, this Letter of Credit is subject to the Uniform Customs and Practics for Documentary Credits, established by The International Chamber of Commerce Publication, applicable on the date of this Letter of Credit.

C7202 1/04



#### SPECIAL INSTRUCTIONS:

This Letter of Credit shall be automatically extended for additional periods of one year from the present or each future expiration date unless we have notified you in writing not less than thirty (30) days before such expiration date, that we elect not to renew this Letter of Credit.

Upon receipt by you of such notice (and whether or not any contract or agreement between applicant and you is then in default), you may draw hereunder by means of your at sight draft on ourselves accompanied by: (1) a written certification purportedly signed by an authorized officer that the amounts drawn will be retained and used by you to meet obligations incurred or to be incurred in connection with one or more contracts or agreements between Applicant and you, and that you will release any amounts not required by you for such purposes to Applicant and (2) the original of this Letter of Credit and the original of any amendments.

#### Partial drawings are allowed.

THE ORIGINAL OF THIS LETTER OF CREDIT MUST BE PRESENTED WITH ANY AND ALL DRAWINGS EFFECTED HEREUNDER. WE HEREBY AGREE WITH YOU THAT DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS CREDIT, THAT SUCH DRAFTS, WILL BE DULY HONORED IF PRESENTED AT NATIONAL BANK OF ARIZONA, DOCUMENTATION DEPT. AZ 7013, 6001 N. 24<sup>th</sup> STREET, PHOENIX, AZ 85016, ON OR BEFORE SEPTEMBER 16, 2005.

DRAFTS DRAWN UNDER THIS CREDIT MUST BE ENDORSED AND CONTAIN THE CLAUSE "DRAWN UNDER NATIONAL BANK OF ARIZONA LETTER OF CREDIT NO. 'DATED SEPTEMBER 17, 2004.

NATIONAL BANK OF ARIZONA

AUTHORIZED SIGNATURE

Universal therwise expressity stated, this Letter of Credit is subject to the Uniform Customs and Prestice for Decumentary Credits, setablished by The International Chamber of Commerce Publication, applicable on the date of this Letter of Credit.